ECONOMIC ASSUMPTIONS

1. ECONOMIC ASSUMPTIONS

Introduction

The economy is in excellent health. Not only are current conditions favorable, but they provide a solid foundation for continued economic progress. During the last two years, the economy achieved the often elusive "soft landing." Real economic growth slowed from the unsustainable 3.5 percent of 1994 to an average of 2 percent per year—close to the Administration's 2.3 percent estimate of the economy's potential growth rate. This occurred without an increase in the unemployment rate. Indeed, during this time, 4.8 million new jobs were created—enough new jobs to absorb all the new entrants into the labor force and raise the employment/population ratio to record levels. Inflation, meanwhile, has been low and relatively stable. In financial markets, interest rates at the end of 1996 were lower than two years ago, and the Dow Jones Industrial average gained 72 percent during 1995–1996.

The Administration projects real growth to continue during the next two years at the same rate as that of the past two years—2.0 percent. This will be enough growth to create millions more new jobs, while holding the unemployment rate close to its current level. Growth of demand is not projected to put in jeopardy the success achieved in the last four years in controlling inflation. Passage of the President's balanced budget plan is expected to bring interest rates down further.

Beyond 1998, the economic assumptions represent anticipated trends rather than a precise cyclical pattern. Assuming that the deficit continues on a path toward balance in 2002, potential growth on average is expected to be slightly faster than in recent years, unemployment and inflation are expected to remain low, and interest rates are likely to continue to decline as the budget approaches balance.

Most private forecasters also share a favorable view of the economic outlook. The most recent Blue Chip consensus forecast, an average of 50 private forecasts, also calls for real GDP growth to average 2.0 percent through 1998 and to pick up a bit thereafter. The consensus expects inflation and unemployment to remain low through 2002. However, the consensus expects interest rates to hold at around current levels, rather than decline as in the Administration's projection. This difference is probably due to differences in fiscal policy assumptions. The Administration assumes that a credible balanced budget agreement will be reached this year and fully implemented in the coming years. If private sector forecasters based their projections on this fiscal policy assumption, they too would likely project a downward trend for interest rates. The broad similarity between these private sector forecasts and the Administration's assumptions indicates that the assumptions provide a reasonable, prudent basis for projecting the budget.

The business cycle expansion that began in April 1991 has already outlasted all but three of the previous 20 expansions during this century. If the expansion continues through December 1998, it will become the century's longest peacetime expansion. If it continues 14 months beyond that date, through February 2000, it will surpass even the record of 106 months set by the 1960s expansion. With inflation under control, incomes and employment on the rise, consumer and business confidence high, interest rates trending down, and fiscal and monetary policy supporting noninflationary growth, this expansion certainly has the potential to enter the record books.

This chapter begins with a review of recent developments, followed by a discussion of two important statistical issues involving the measurement of real growth and inflation that are relevant to understanding recent trends. Next, the Administration's projections are presented and compared with those of the Congressional Budget Office (CBO). The chapter concludes with an analysis of the impact on the projected deficit of changes in economic assumptions since last year's budget, and with estimates of the sensitivity of the budget to changes in economic assumptions.

Fiscal and Monetary Policy

The favorable economic environment currently prevailing and the buoyant outlook reflect the underlying strength of the American economy when it is supported by sound fiscal and monetary policies. The Omnibus Budget Reconciliation Act of 1993 (OBRA93) was intended to set the budget deficit on a sharp downward path. In 1992, prior to passage of OBRA93, the deficit hit a postwar record of $290 billion, 4.7 percent of gross domestic product (GDP). Since then, the deficit has shrunk in every year. In 1996, the deficit was only $107 billion, the lowest level in 15 years and just 1.4 percent of GDP. The last time the deficit share was this low was over two decades ago. Special factors added to the deficit's decline in 1996, and without those special factors in 1997, the deficit is expected to increase modestly. However, if the President's budget is adopted, the deficit will resume its downward trend in 1998.

The Administration originally estimated that OBRA93 would reduce deficits during 1994–98 by a cumulative total of $505 billion. The budget and the economy have far outperformed the projections made in 1993. It now seems likely that the cumulative deficit reduction through 1998, even without the further deficit reductions proposed in this budget, will be around $924 billion.

The lower deficit path contributed greatly to the economy's soft landing in 1995–1996. It enabled interest rates to decline, rather than rise—as has often occurred at similar stages of past business cycles. Lower interest rates, in turn, have helped propel the stock market, thereby lowering businesses' cost of capital and boosting household wealth. Lower interest rates have stimulated business investment in new plant and equipment and household interest-sensitive purchases of durable goods and new homes. The ensuing boost to business and household demand created new jobs and raised incomes as the economy continued to grow neither too fast nor too slowly. It also increased the Nation's productive capacity, and helped productivity to grow faster—thereby providing protection against future inflation.

Monetary policy helped to engineer the soft landing by acting preemptively to prevent inflation from picking up as the economy approached its potential output. In the past, when the economy approached capacity, excessive demands in labor and product markets often pushed it beyond the noninflationary limits. The ensuing strains caused inflation to accelerate, and forced the monetary authorities to tighten policy and precipitate a recession.

In this expansion, however, monetary policy tightened in 1994 and early 1995, when the economy was growing rapidly but before inflationary pressures had yet appeared. During 1995 and early 1996, as the pace of economic activity slowed and incipient inflationary pressures waned, the Federal Reserve gradually relaxed monetary policy to support economic growth. The last move in this direction occurred in January 1996 when the Federal Open Market Committee reduced the federal funds rate ¼ percentage point to 5¼ percent. During the past year, as the soft landing became evident, the Federal Reserve kept monetary policy unchanged.

The stability of monetary policy since January 1996 helped maintain short-term interest rates at relatively stable levels. The 3–month Treasury bill rate has been on a plateau near 5 percent. Long-term rates have been more volatile, moving up as the pace of activity quickened in the spring and down as the economy slowed in the second half of the year. During the first six months of the year, the 10–year Treasury bond yield rose 1¼ percentage points to 7 percent in June. By the end of the year, however, the rate was 6.3 percent. Although higher than at the end of 1995, that rate was still 1½ percentage points lower than two years earlier, and very low by historical standards for periods with similar unemployment and economic growth.

Recent Developments

Real Growth: The economy expanded an estimated 2.8 percent over the four quarters of last year, up from the 1.3 percent pace of the prior year. Several important but transitory factors restrained growth around the start of 1996. The Federal Government was partially shut down twice by budgetary disputes between the Administration and Congress. In addition, a severe January blizzard paralyzed business activity on the East Coast; and in March, motor vehicle production was sharply curtailed by a strike at General Motors, the Nation's largest automaker. In the second quarter, however, the economy grew at nearly a 5 percent annual rate as it made up for the earlier losses of output and sales. In the second half of the year, the pace of economic activity moderated.

The fastest-growing component of GDP last year was business fixed investment, which was up at a double-digit pace during the first three quarters of the year. Outsized advances in spending on computers and other information processing equipment continued to lead the way, but businesses also boosted their outlays for other types of equipment and structures. During the past two years, business investment has been propelled by a need to reduce costs in competitive world markets, and also to expand capacity as the economy operated close to its potential, leaving little excess capacity to exploit. During 1995–1996, industrial capacity grew by 4 percent annually, up from the 2½-percent average of the prior three years. Business inventory investment also contributed to GDP growth last year, especially in the third quarter. A pick-up in final sales in the fourth quarter kept inventories in line with sales.

The expansion was also supported by the household sector's willingness and ability to purchase big-ticket durable goods and homes. Consumer confidence rose during the year, and by the second half was at its highest level in years. Expanding employment and income and a booming stock market provided consumers with the wherewithal to spend. Over the first three quarters of the year, consumer spending rose at a 2½-percent annual rate, led by durable goods purchases. New home sales during the first 11 months of the year reached the highest level in 17 years, helping to push housing starts to the highest level in eight years. The residential investment component of GDP increased at a 6 percent annual rate over the first three quarters of the year.

Even the government sector contributed modestly to growth last year. Over the first three quarters, Federal Government consumption and gross investment rose at a 4 percent annual rate. All of the growth, however, was attributable to a catch-up for the lost activity during the shutdowns in the fourth quarter of 1995. By the third quarter of 1996, the Federal component of GDP was lower than a year earlier. State and local governments' consumption and gross investment rose at a 2¼ percent rate over the first three quarters of 1996, about the same pace as during 1995. State and local government finances have benefited from the long expansion, which has boosted revenues.

The foreign sector was the main restraint on GDP growth last year. During the first three quarters, net exports of goods and services slowed growth by 1 percentage point. The wider trade deficit reflected the stronger growth of domestic demand in the U.S. than in several of our trading partners.

Labor Markets: During 1996, nearly 2.6 million new jobs were created, bringing the total since this Adminis-

tration came into office in January 1993 to 11.2 million. Almost all the new jobs added last year were in the private sector, primarily in service industries. Manufacturing payrolls shrank for the second consecutive year. The availability of jobs throughout the country provided the incentive for more people to enter the labor force and to find work. By the fourth quarter of 1996, both the labor force participation rate and the employment/population ratio had reached their highest levels in the postwar period.

The unemployment rate last year averaged 5.4 percent, the lowest level since 1989. By the end of the year, 32 States had unemployment rates of 5 percent or less. Unemployment rates were 4 percent or less in States with the tightest labor markets. Even areas of the country that had lagged behind in job creation earlier in the recovery experienced favorable job markets and the lowest unemployment rates in years. By the end of 1996, almost all demographic groups enjoyed lower unemployment rates than a year earlier.

Inflation: Despite the low unemployment rate last year, inflation remained under control. The broadest measure of inflation, the GDP chain-weighted price index, rose at just a 2.2 percent annual rate during the first three quarters, down from 2.5 percent during 1995. As for consumer prices, core inflation measured by the Consumer Price Index excluding food and energy increased only 2.6 percent during 1996, the slowest rise since 1965. The overall Consumer Price Index rose 3.3 percent last year, mainly because of sharp increases in energy prices. These are not expected to be repeated in 1997.

The low inflation rate was made possible by a moderate growth of labor compensation. The most comprehensive measure of labor compensation, the Employment Cost Index (ECI), rose just 2.8 percent during the most recent 12 months, virtually the same as it did during the previous year. This is the smallest rise since the series began in 1981. The ECI is composed of both benefits and wages. In recent years, benefit costs have slowed substantially. Firms have been able to rein in health insurance costs thanks to innovations in health care delivery, and have also been able to reduce their contributions to retirement programs because of booming equity markets. Cash wages, however, increased more rapidly in the past year. This is consistent with the results of most studies that reveal that there is a trade-off between benefits and cash wages. Savings in benefit costs eventually are passed on to workers in the form of higher cash wages.

The favorable inflation performance last year sheds new light on the key question for monetary policy: What is the current threshold level of unemployment below which inflation tends to accelerate (and above which it decelerates)? This threshold has been called NAIRU—for "nonaccelerating inflation rate of unemployment." For much of the 1980s, the consensus was that NAIRU was in the neighborhood of 6 percent. This estimate proved to be consistent with the experience of 1987–1990, when inflation increased as unemployment fell below 6 percent.

A 6 percent estimate of NAIRU, however, is not consistent with the experience since 1994. Last year, unemployment averaged 5.4 percent. If NAIRU was 6 percent, inflation should have risen; instead it declined, as measured by the GDP chain-weighted price index and by the core CPI. In light of recent experience, it is likely that NAIRU is now well below 6 percent. In the 1997 Budget, the Administration had assumed NAIRU was 5.7 percent; in this Budget, NAIRU is assumed to be 5.5 percent, in part because of the moderate inflation experienced last year.

A decline in NAIRU in recent years can be attributed to three factors. First, the aging of the baby boomers has shifted the composition of the labor force towards groups that have lower unemployment rates. To achieve the same degree of labor market tightness in 1996 as a decade earlier would now require a lower overall unemployment rate. Second, heightened competition in product and labor markets may have made businesses less able to raise their prices, and workers more cautious in seeking wage gains. Finally, for much of the 1970s and early 1980s, wage demands appear to have been based on unrealistic expectations of productivity growth that did not incorporate the productivity slowdown that began in 1974. Because of these demands, the level of NAIRU consistent with stable inflation was higher. By 1996, however, the wage and productivity relationship was in better balance.

Statistical Issues

Serious questions have been raised recently about whether real GDP accurately measures the economy's growth and whether the CPI accurately measures inflation.

Real Growth: In the past two years, a wide and growing discrepancy has developed between growth measured by the change in output (the familiar real GDP) and growth measured by the increase in real income (real Gross Domestic Income). In the two years ending in the third quarter of 1996, the most recent data available, real GDP rose at an average annual rate of 2.1 percent. Growth measured by real Gross Domestic Income (GDI), however, was up at a more rapid 3.1 percent rate. In the third quarter of 1996, the discrepancy had widened to 2.1 percentage points: GDP was up at a 2.1 percent annual rate, but GDI was up at a 4.2 percent pace.

In an ideal world, the two measures would be equal. In reality, they always differ because of inconsistencies and gaps in source data. The differences, however, have rarely been as large as they are now. The difference between the output and income measures is called the statistical discrepancy; it was nearly $100 billion in the third quarter of 1996—a record 1.3 percent of nominal GDP.

The divergent readings during the last two years make it difficult to ascertain how fast the economy has grown and where the economy is with respect to

potential output. There are three reasons, however, for believing that the output measure of growth may be an underestimate.

- First, Treasury receipts during 1996 came in strong. While some of this may be due to capital gains receipts spurred by the booming stock market, which are not included in the national accounts measures, some may also be from taxes levied on economic activity that is not showing up on the output side (that is, GDP). The receipts growth is less puzzling in light of the higher income-side measure.
- Second, with GDP growth in the neighborhood of a 2.0 percent annual rate during the past two years, the unemployment rate might have been expected to have held steady or even risen slightly. Instead, it fell 0.3 percentage point, which is more consistent with the growth rate measured from the income side.
- Third, growth rates closer to the higher income-side reading would mean that productivity growth was also stronger than reported and unit labor cost growth less than reported. That more favorable scenario fits better with the subdued inflation experienced last year.

The incorporation of new source data in the forthcoming July benchmark revisions to the National Income and Product Accounts may narrow the difference between the output and income sides. On the other hand, the difference is so large that even after the benchmark there may still be considerable uncertainty about the pace of economic activity in recent years.

Inflation: In December, the Advisory Commission to Study the Consumer Price Index, appointed by the Senate Finance Committee and led by Michael Boskin, former Chairman of the Council of Economic Advisers, reported its finding that the Consumer Price Index for urban consumers (CPI-U), compiled by the Bureau of Labor Statistics (BLS), overestimates annual changes in the cost of living by 1.1 percentage points. The Commission's findings were controversial. Although there is a widely shared view that problems in calculating the CPI may give it an upward bias, there is far less agreement over the size of the bias and over the practical steps that should be taken to remedy it.

The BLS continually tests the CPI and regularly makes improvements in it when problems are discovered. It has been unable to identify quantitatively more than a fraction of the bias reported by the Commission. Recently, BLS has proposed a number of changes in the way it computes the CPI that are expected to reduce measured inflation over the next several years.

The CPI is a "fixed-weight" price index. The market basket on which it is based consists of about 200 categories of goods and services which are updated only once every 10 years or so. Within each of these categories, however, about one-fifth of the individual items are replaced each year, so the CPI can keep current with changing brands and other minor variations in consumption patterns. Essentially, the CPI measures how much this market basket costs each month. The CPI was last updated in 1987 to reflect consumption patterns in 1982–1984; the next rebasing is scheduled for January 1998 when 1993–1995 spending patterns will be used.

The CPI has some long-recognized disadvantages which are highlighted in the Advisory Commission's report. In the first place, when relative prices change, people change their consumption patterns to reduce the effects of such changes on their living standards; because it is a fixed-weight index, the CPI misses these adjustments. And, because it is not based on current spending patterns, the CPI can miss the introduction of new products, which often have sharp price declines early in their life cycle. Also, when consumers switch from department stores to discount outlets to save money on name-brand merchandise, the BLS does not record this as a drop in consumer prices, because the discount outlets are assumed to provide less service.

The single largest source of bias identified by the Advisory Commission is insufficient adjustment for quality changes. Sometimes goods rise in price because their quality improves; for example, the higher prices paid today for many medical services may reflect the higher quality of these services, including a better chance of survival and less pain or confinement during treatment. Quality can also decline, of course, and if such changes are missed then the CPI would understate inflation. The BLS attempts to capture the effects of quality changes where there are reliable measures. For example, beginning this year, the BLS revised the way it treats hospital costs to account better for quality improvements. Most experts acknowledge that the task of incorporating quality changes into the CPI is quite difficult.

If the upward bias is as large as the Advisory Commission suggests, recent economic history would have to be rewritten to reflect the revised inflation estimate. For example, the decline in real weekly wages over the past three decades would be reversed if the CPI has really been overstated consistently by 1.1 percentage points per year since 1965. Real economic growth would also be raised by between 0.5 and 1.0 percentage points per year. Productivity growth would show a comparable increase. These are large changes, and it is not yet clear whether there is other evidence to support such wholesale revisions to recent history. This is another reason why the Advisory Commission's findings have been controversial.

Because many Federal benefit programs and tax provisions are indexed to the CPI, a lower rate of increase in the CPI would be helpful to the budget. Limiting the rate of change in the CPI by 1.1 percentage points per year compared with the current Administration forecast would lower the deficit projected in 2002 by $58 billion, and would reduce the cumulative deficit between 1997 and 2002 by $145 billion. These figures indicate how important the CPI is to the budget, but they are not necessarily a reason for changing the indexing formulas that rely on the CPI. Because the CPI

is important to the budget and to a wide variety of private contracts, any changes made to this index need to be studied carefully and justified thoroughly.

While the Advisory Commission has recommended changes in technical practices at BLS that might be expected to reduce the bias in the CPI, the actual effects of these changes remain to be determined. Moreover, the recommended procedures would require data that are not currently available in time for the monthly production of the CPI. In preparing its report, the Advisory Commission relied heavily on retrospective data that are unavailable when the CPI is actually produced. Other gaps in the data were filled by the informed judgements of its authors. This is a common practice in academic studies, and it is appropriate in that context, but it would be questionable in a Federal statistical series that must be based on objective data.

The technical experts at BLS, who have a long research tradition that has exposed weaknesses in the CPI in the past and provided remedies for them, will continue the scheduled sequence of improvements while continuing to refine the estimates of other possible biases. Improvements in procedures for hospital costs in January of 1997 will likely reduce measured inflation; and updating the CPI market basket in 1998 can be expected to lower reported inflation by bringing the market basket weights more in line with current experience.

All observers agree that the Nation needs the best possible measure for the cost of living. No change will be made to the CPI that is not technically appropriate for the better measurement of living costs.

Economic Projections

Key assumptions: The economic projections underlying this budget are summarized in Table 1–1. They are based on the crucial assumption that the budget will be adopted. If it is, the deficit will be progressively reduced until the budget achieves a surplus by 2002. Deficit reduction is expected to continue to foster the favorable macroeconomic environment experienced in recent years. Interest rates would come down and private sector investment would continue to grow, without

Table 1–1. ECONOMIC ASSUMPTIONS [1]

(Calendar years; dollar amounts in billions)

	Actual 1995	Projections						
		1996	1997	1998	1999	2000	2001	2002
Gross Domestic Product (GDP):								
Levels, dollar amounts in billions:								
Current dollars	7,254	7,577	7,943	8,313	8,717	9,153	9,610	10,087
Real, chained (1992) dollars	6,743	6,901	7,056	7,197	7,355	7,525	7,699	7,877
Chained price index (1992 = 100), annual average	107.6	109.9	112.7	115.7	118.7	121.8	125.0	128.2
Percent change, fourth quarter over fourth quarter:								
Current dollars	3.8	5.0	4.6	4.7	5.0	5.0	5.0	5.0
Real, chained (1992) dollars	1.3	2.8	2.0	2.0	2.3	2.3	2.3	2.3
Chained price index (1992 = 100)	2.5	2.3	2.5	2.6	2.6	2.6	2.6	2.6
Percent change, year over year:								
Current dollars	4.6	4.5	4.8	4.7	4.9	5.0	5.0	5.0
Real, chained (1992) dollars	2.0	2.3	2.2	2.0	2.2	2.3	2.3	2.3
Chained price index (1992 = 100)	2.5	2.2	2.5	2.6	2.6	2.6	2.6	2.6
Incomes, billions of current dollars:								
Corporate profits before tax	599	652	676	714	757	796	816	849
Wages and salaries	3,431	3,628	3,808	3,982	4,168	4,374	4,590	4,810
Other taxable income [2]	1,532	1,612	1,684	1,748	1,809	1,882	1,967	2,068
Consumer Price Index (all urban): [3]								
Level (1982–84 = 100), annual average	152.5	156.9	161.2	165.5	170.0	174.6	179.3	184.1
Percent change, fourth quarter over fourth quarter	2.7	3.1	2.6	2.7	2.7	2.7	2.7	2.7
Percent change, year over year	2.8	2.9	2.7	2.7	2.7	2.7	2.7	2.7
Unemployment rate, civilian, percent:								
Fourth quarter level	5.5	5.3	5.4	5.6	5.5	5.5	5.5	5.5
Annual average	5.6	5.4	5.3	5.5	5.5	5.5	5.5	5.5
Federal pay raises, January, percent:								
Military	2.6	2.6	3.0	2.8	3.0	3.0	3.0	3.0
Civilian [4]	2.6	2.4	3.0	2.8	NA	NA	NA	NA
Interest rates, percent:								
91–day Treasury bills [5]	5.5	5.0	5.0	4.7	4.4	4.2	4.0	4.0
10–year Treasury notes	6.6	6.5	6.1	5.9	5.5	5.3	5.1	5.1

NA = Not Available.

[1] Based on information available as of mid-November 1996.

[2] Rent, interest, dividend and proprietor's components of personal income.

[3] CPI for all urban consumers. Two versions of the CPI are now published. The index shown here is that currently used, as required by law, in calculating automatic adjustments to individual income tax brackets. Projections reflect scheduled changes in methodology.

[4] Overall average increase, including locality pay adjustments. Percentages to be proposed for years after 1998 have not yet been determined.

[5] Average rate (bank discount basis) on new issues within period.

any buildup of inflationary pressures. This would allow interest rates to decline without igniting inflation.

Real GDP and unemployment: Over the next two years, real GDP is expected to rise 2.0 percent annually, close to the rate of the past two years. During 1999–2002, the pace of growth is expected to quicken to 2.3 percent annually—the Administration's estimate of the economy's potential growth rate. As in recent years, the fastest growing component of GDP is likely to be business fixed investment, stimulated by the fall in interest rates. Federal consumption and gross investment is projected to decline as the budget moves towards balance. The net export component of GDP is expected to move from deficit to surplus as the Federal deficit shrinks, and there is less need for capital from abroad to support domestic investment.

The faster GDP growth in the outyears is due to an expected boost in trend productivity growth that is likely to accompany higher rates of investment. Productivity growth is projected to average 1.2 percent per year during the next seven years. By way of reference, from the last cyclical peak in the third quarter of 1990 to the third quarter of 1996, productivity growth was 0.9 percent per year measured from the output side and 1.2 percent measured from the income side.

Potential GDP growth can be decomposed into the trend growth of productivity (1.2 percent) and the growth of the labor force. The Administration's projection assumes that the working age population will grow 1.0 percent annually during the next seven years, and the labor force participation rate will edge up 0.1 percent per year. This labor force projection assumes that the trends of the past six years will continue, which represents a significant break with experience in 1974–1990 when both population and labor force participation were growing more rapidly. With the baby boom generation well into its working years, and both the labor force participation rate and the employment/population ratio already at record levels, it is prudent to project continued but slower growth of the work force in the future.

The real GDP growth projection of 2.0 percent during the next two years is consistent with a slight rise in the unemployment rate, edging up from the 5.4 percent average of last year to 5.5 percent by 1998. Thereafter, real growth is expected to be at the potential growth rate, implying that the unemployment rate would remain stable.

Inflation: With projected unemployment close to or at NAIRU throughout the budget forecast, inflation is expected to remain steady. The GDP chain-weighted price index is projected to stay on a plateau of 2.6 percent annual growth. The CPI is expected to grow 2.7 percent per year in almost every year, slightly slower than the 3.3 percent actual for 1996. The CPI would continued to grow about 3.0 percent during 1997–1998 if not for methodological improvements already instituted or planned by the Bureau of Labor Statistics. These are expected to trim the annual growth of the CPI by about 0.3 percentage point.

Interest rates: Short- and long-term interest rates are expected to decline as a result of the passage of the Administration's budget proposals, which will reduce the Government's demands on credit markets. The 91–day Treasury bill rate is expected to decline steadily from 5.0 percent at the end of 1996 to 4.0 percent by 2001 and then hold at that level. The 10–year Treasury bond yield, which was 6.3 percent at the end of last year, is projected to fall to 5.1 percent by 2001 and remain at that level. With inflation holding steady, these interest rate projections imply a reduction in real interest rates to levels seen previously when the Federal budget was closer to balance.

Incomes: The decline in interest rates is expected to have important but largely offsetting impacts on the income of the household sector, a net lender in the economy, and the corporate sector, a net borrower. The share of personal interest income of the household sector in nominal GDP is expected to decline because of lower rates. On the other hand, the fall in rates will help keep the share of profits near the historically high levels that prevailed during 1996. During the first three quarters of last year, the share of corporate profits before tax in nominal GDP was the highest since 1979. The share of wages and salaries in nominal GDP is projected to remain close to the level of last year. Aggregate wages and salaries are projected to rise nearly 40 percent from 1996 to 2002. After adjustment for inflation, real wages and salaries are expected to increase 15 percent.

Comparison with CBO

The Congressional Budget Office (CBO) prepares the economic projections used by Congress in formulating budget policy. In the executive branch, this function is performed jointly by the Treasury, the Council of Economic Advisers (CEA), and OMB. It is natural that the two sets of economic projections be compared with one another, but there are several important differences, along with the similarities, that should be kept in mind:

- The Administration's projections always assume that the President's policy proposals in the budget will be adopted in full. Currently, that means the deficit will be progressively reduced until the budget achieves a surplus in 2002. In contrast, CBO normally assumes that current law will continue to hold; thus, it makes a "pre-policy" projection. Both last year and this, however, CBO also presented economic projections based on a fiscal policy similar to the budget's.
- Both CBO and the Administration believe that balancing the Federal budget by 2002 would have significant macroeconomic effects, especially for interest rates and the distribution of income. The Administration does not present an explicit estimate of the fiscal dividend in this budget. CBO's

estimates of the dividend show that it is smaller now than it was a year ago, partly because the budget is already closer to balance.

- The two sets of projections are often prepared at different times. The Administration's projections must be prepared months ahead of the release of the budget. Some of the differences in the Administration's and CBO's near-term forecasts, therefore, may be due to the availability of more recent data to CBO; a direct comparison with the CBO projections is not always meaningful. Timing differences are much less likely to play an important role in any differences in outyear projections, however.

Table 1–2 presents a summary comparison of the two sets of projections based on the common assumption that the deficit will be eliminated by 2002.

- *Real GDP:* The projections of real GDP growth are quite similar. The Administration projects that real GDP will grow at an average rate of 2.2 percent from 1997–2002; CBO projects a 2.1 percent average growth rate.
- *Inflation:* Both the Administration and CBO expect inflation to continue at a slow, steady rate over the next several years. For the chain-weighted GDP price index, both predict that inflation will be 2.6 percent yearly beginning in 1998; CBO expects the annual rate of change in the CPI to be about one-quarter percentage point higher than the Administration.
- *Unemployment:* CBO projects unemployment to rise from its current level to around 6 percent. The Administration believes unemployment can stabilize near its current level without raising the rate of inflation.
- *Interest rates:* Both the Administration and CBO have a similar decline in short-term interest rates. The Administration, however, projects a slightly larger drop in long-term rates than does CBO.
- *Income distribution:* Both CBO and the Administration expect a shift of income from interest to corporate profits as a result of the lower interest rates produced by a balanced budget. The corporate sector is a net borrower and the profits share of GDP benefits from lower interest rates. In part because the Administration assumes a larger decline in long-term interest rates than does CBO, it projects a larger shift into profits.

CBO has a good economic forecasting record. During much of the 1980s its forecasts were more accurate than those of the Administration. The record over the last four years, however, has been more mixed. Since it took office in 1993, this Administration has placed the highest priority on careful and prudent economic forecasts. Partly because of its conservative approach to forecasting the deficit, the Administration has overestimated the deficit by about $50 billion on average in the budgets submitted for fiscal years 1994–1996. It is too early to tell whether this pattern will continue, but even the Mid-Session estimate of the 1996 deficit proved to be an overestimate.

It would be preferable to project the deficit without any error, but that is not possible. Still, the Administration's cautious approach has meant that the projection misses have helped and not hurt in the effort to reduce the deficit. There are a number of reasons why the

Table 1–2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years)

	Projections					
	1997	1998	1999	2000	2001	2002
Real GDP (chain-weighted) [1]:						
CBO January [2]	2.1	2.1	2.2	2.2	2.1	2.1
1998 Budget	2.0	2.0	2.3	2.3	2.3	2.3
Chain-weighted GDP Price Index [1]:						
CBO January [2]	2.4	2.6	2.6	2.6	2.6	2.6
1998 Budget	2.5	2.6	2.6	2.6	2.6	2.6
Consumer Price Index (all-urban) [1]:						
CBO January [2]	2.9	3.0	3.0	3.0	3.0	3.0
1998 Budget	2.6	2.7	2.7	2.7	2.7	2.7
Unemployment rate [3]:						
CBO January [2]	5.3	5.6	5.8	5.9	6.0	6.0
1998 Budget	5.3	5.5	5.5	5.5	5.5	5.5
Interest rates [3]:						
91–day Treasury bills:						
CBO January [2]	5.0	5.0	4.6	4.2	3.9	3.9
1998 Budget	5.0	4.7	4.4	4.2	4.0	4.0
10–year Treasury notes:						
CBO January [2]	6.2	6.1	5.8	5.5	5.5	5.5
1998 Budget	6.1	5.9	5.5	5.3	5.1	5.1

[1] Percent change, fourth quarter over fourth quarter.
[2] Economic projections assuming balanced budget policy.
[3] Annual averages, percent.

budget has performed better than expected. Some of these are technical shifts; for example, Medicaid spending has fallen short of expectations for technical reasons. In addition, however, the economy has performed as well as or better than the Administration has assumed, and even more in excess of CBO's expectations.

Because of the revisions to GDP adopted in January of 1996 by the Commerce Department, it is impossible to show a consistent history of real growth projections for both last year and the earlier years of the Administration. Looking at the unrevised data through 1995, however, the Administration was more accurate than CBO in its initial forecast of real GDP growth, but still underpredicted the actual performance of the economy by 0.8 percentage point per year on average. In subsequent forecasts, the Administration has also been slightly more accurate in projecting real GDP. Over the last four years, the Administration has been more accurate than CBO in its forecast of unemployment, but still has consistently overestimated the unemployment rate. CBO has also tended to resist the mounting evidence for a significant increase in the GDP share of corporate profits as a result of lower interest rates and the greater competitiveness of U.S. business. The Administration's projections of the profits share were closer to the actual outcome.

The differences in economic assumptions between the Administration and CBO have been small—smaller than they were under previous Administrations, and well within the usual range of error in such projections. However, even small differences in economic assumptions can yield sizable differences in budget projections when extended over several years. Given the positive economic outlook in the United States—strong and steady growth, robust job creation, and low inflation and interest rates with none of the excesses that suggest an economic downturn—there are sound reasons for believing that the Administration's projection is likely to be close to the actual outcome. In that case, the President's budget as presented in the document would continue in force through 2002, with no need to limit spending or suspend tax cuts to achieve a balanced budget.

Can We Do Better?

The Administration's average projected rate of growth for real GDP over the budget period—2.2 percent per year—is about equal to the estimate of potential noninflationary growth held by a broad consensus of the economics profession. It is natural to wonder if the economy is capable of doing better than this. The Administration is optimistic that it can, and has proposed the policies that are most likely to raise potential growth. However, it would not be prudent to base the budget on best-case assumptions, or even on assumptions much above the middle ground. Previous Administrations made that mistake, and one result was a sequence of large, unanticipated deficits.

Statistical problems suggest that growth might already be faster than we think. The possible mismeasurement of GDP on the "output" side (as opposed to Gross Domestic Income, on the "income" side) may have reduced measured average growth over the past six years by as much as ¼ percentage point. The Administration assumes that the true rate of growth over this period was better approximated by the growth of incomes, and that assumption is reflected in the projected 2.3 percent growth rate for potential GDP.

The possibility that the CPI is mismeasured also affects GDP. As indicated above, an overstatement of 1.1 percentage point per year in the measurement of the CPI would have cut measured real GDP growth by between 0.5 and 1.0 percentage point. Correcting for such an error would raise the Administration's projected real growth rate to around 3 percent per year.

Another factor affecting the current measured growth rate of real GDP should not be a cause for concern. The growth of total output is equal to the sum of the growth rate of labor productivity and the growth rate of hours worked. The Administration projects that hours worked will increase by less than in the past. There are two benign reasons for the expected slowdown:

- The working-age population is growing more slowly than it did in earlier decades, purely because of lower historical birth rates. Family incomes and individual well-being should not be affected by such a slowdown.
- Both the rate of labor force participation and the percentage of the population employed are already at record levels, and accordingly are not expected to rise at the rates of recent years. During the past two decades there was a massive inflow of women into the paid labor force. That inflow has slowed, and there are signs that the rate of female labor force participation is stabilizing. This is not necessarily a cause for alarm even though it means slower growth in total hours worked and less real GDP growth. The voluntary decisions of people to enter or leave the labor force ought to be respected by Government, and incomes can rise on a per capita or per family basis whether or not labor force participation is increasing. If unemployment is low and jobs are plentiful, as they are now, then those women (and men) who would like to work have the best opportunity to do so.

Because of these changes, the average growth rate of hours worked is expected to decline from an average of about 1.7 percent per year during the 1970s and 1980s to around 1.2 percent per year for the next six years. This decline will reduce real GDP growth by a corresponding amount.

A further increase in productivity growth would be highly desirable, and Administration initiatives in education, technology, and regulatory reform are intended to improve productivity. But raising the trend rate of productivity growth has proved very difficult, however often policymakers have espoused that goal; therefore, a prudent assumption is to project a continuation in the prevailing productivity trend while working to ex-

Table 1–3. SAVING, INVESTMENT, AND TRADE BALANCE

(Fiscal years; in billions of dollars)

	1996 actual	1998 estimate
Current account	–154	–180 to –140
Merchandise trade balance	–181	–210 to –170
Net foreign investment	–140	–175 to –135
Net domestic saving (excluding Federal saving) [1]	460	440 to 480
Net private domestic investment	393	415 to 455

[1] Defined for purposes of Public Law 100–418 as the sum of private saving and the current surpluses of State and local governments. All series are based on the National Income and Product Accounts (NIPA) measures except for the current account balance.

ceed that conservative forecast. If this course is successful, then inflation will be less than expected and the deficit will be smaller too. These surprises would be welcome.

Omnibus Trade and Competitiveness Act of 1988

As required by the Omnibus Trade and Competitiveness Act of 1988, Table 1–3 shows estimates for economic variables related to saving, investment, and foreign trade consistent with the economic assumptions.

The merchandise trade and current account deficits deteriorated in fiscal year 1996 and are expected to stabilize near current levels through fiscal year 1998. Net private investment in the United States has expanded rapidly during this Administration, and it is expected to continue to increase as the economy expands. The sources for the increased private investment have been the decline in the Federal deficit and higher private saving, plus a larger inflow of foreign capital.

The Act requires information on the amount of borrowing by the Federal Government in private credit markets. This is presented in Chapter 12, "Federal Borrowing and Debt."

It is difficult to gauge with precision the effect of Federal Government borrowing from the public on interest rates and exchange rates, as required by the Act. Both are influenced by many factors besides Government borrowing in a complicated process involving supply and demand for credit and perceptions of fiscal and monetary policy here and abroad.

Impact of Changes in the Economic Assumptions

The economic assumptions underlying this budget are similar to those of last year. Both budgets envisaged that achieving a balanced budget would result in a substantial decline in interest rates that would serve to extend the economic expansion at a moderate pace while helping to maintain low, steady rates of inflation and unemployment. A shift to a balanced budget and the ensuing lower interest rates were also expected to shift income from interest to profits. This would have favorable effects on budget receipts and the deficit, be-

Table 1–4. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 1997 AND 1998 BUDGETS

(Calendar years; dollar amounts in billions)

	1996	1997	1998	1999	2000	2001	2002
Nominal GDP:							
1997 budget assumptions	7,621	8,008	8,417	8,848	9,295	9,772	10,268
1998 budget assumptions	7,577	7,943	8,313	8,717	9,153	9,610	10,087
Real GDP (percent change): [1]							
1997 budget assumptions	2.2	2.3	2.3	2.3	2.3	2.3	2.3
1998 budget assumptions	2.8	2.0	2.0	2.3	2.3	2.3	2.3
GDP price index (percent change): [1]							
1997 budget assumptions	2.8	2.7	2.7	2.7	2.7	2.7	2.7
1998 budget assumptions	2.3	2.5	2.6	2.6	2.6	2.6	2.6
Consumer Price Index (percent): [2]							
1997 budget assumptions	3.1	2.9	2.8	2.8	2.8	2.8	2.8
1998 budget assumptions	3.1	2.6	2.7	2.7	2.7	2.7	2.7
Civilian unemployment rate (percent): [2]							
1997 budget assumptions	5.7	5.7	5.7	5.7	5.7	5.7	5.7
1998 budget assumptions	5.4	5.3	5.5	5.5	5.5	5.5	5.5
91–day Treasury bill rate (percent): [2]							
1997 budget assumptions	4.9	4.5	4.3	4.2	4.0	4.0	4.0
1998 budget assumptions	5.0	5.0	4.7	4.4	4.2	4.0	4.0
10–year Treasury note rate (percent): [2]							
1997 budget assumptions	5.6	5.3	5.0	5.0	5.0	5.0	5.0
1998 budget assumptions	6.5	6.1	5.9	5.5	5.3	5.1	5.1

[1] Fourth quarter-to-fourth quarter.
[2] Calendar year average.

cause profits face a higher marginal tax rate than interest income.

The changes in the economic outlook since last year's budget have been relatively modest. On the positive side, the differences are primarily the result of more favorable economic experience in 1996 than was anticipated in last year's assumptions; on the negative side, partly because of the failure to enact a balanced budget, interest rates did not decline as was anticipated in last year's assumptions. Indeed, interest rates increased during the first half of the year. Even so, inflation and unemployment continued to improve in 1996. Because of this favorable experience, the forecast average for the unemployment rate has been lowered by 0.2 percentage point, and inflation has been reduced by 0.1 percentage point. Meanwhile, interest rates are again assumed to decline in this budget, but the descent begins a year later than previously assumed, and the decline is smaller in percentage points.

The net effects on the budget of these modifications in the economic outlook are shown in Table 1–5. The last column in the table shows the effect in 2002. The largest effects come from lower receipts due to lower inflation and lower real GDP growth in 1997 and 1998, and from the shift in timing of the expected decline in interest rates. Because the decline starts a year later, interest rates are higher in this budget, which increases the deficit relative to last year's estimates. The budget surplus projected for 2002 would have been about $43 billion larger had last year's economic assumptions been used in place of this year's assumptions.

Structural vs. Cyclical Deficit

When there is slack in the economy, receipts are lower than they would be if resources were fully employed, and outlays for unemployment-sensitive programs (such as unemployment compensation and food stamps) are higher. As a result, the deficit is higher than it would be if unemployment were at NAIRU. The portion of the deficit that can be traced to such factors is called the cyclical deficit. The remainder, the portion that would remain with unemployment at NAIRU (consistent with a 5.5 percent unemployment rate), is called the structural deficit.

Changes in the structural deficit give a better picture of the impact of budget policy on the economy than does the unadjusted deficit. During a recession or the recovery from one, the structural deficit also gives a clearer picture of the deficit problem that fiscal policy must address, because this part of the deficit will persist even when the economy has fully recovered, unless policy changes.

In the early 1990's, large swings in net outlays for deposit insurance (the S&L bailouts) had substantial impacts on deficits, but had little impact on economic performance. It therefore became customary to remove deposit insurance outlays as well as the cyclical component of the deficit from the actual deficit to compute the adjusted structural deficit. This is shown in Table 1–6.

Because the economy is projected to be quite close to full employment over the forecast horizon, the cyclical component of deficits is small. Indeed, for 1996 and 1997, the unemployment rate is slightly below the full employment rate of 5.5 percent, resulting in negative cyclical components of the deficit (cyclical surpluses). Deposit insurance net outlays are relatively small and do not change greatly from year to year. Thus, rather unusually, the adjusted structural deficits in this budget display much the same pattern of year-to-year changes as the actual deficits. The most significant

Table 1–5. EFFECTS ON THE BUDGET OF CHANGES IN ECONOMIC ASSUMPTIONS SINCE LAST YEAR

(In billions of dollars)

	1997	1998	1999	2000	2001	2002
Budget totals under 1997 budget economic assumptions and 1998 budget policies:						
Receipts	1,517.3	1,585.4	1,668.8	1,754.4	1,839.6	1,932.4
Outlays	1,630.3	1,677.9	1,748.4	1,802.9	1,834.8	1,872.1
Surplus or deficit (–)	–113.0	–92.6	–79.7	–48.5	4.9	60.3
Changes due to economic assumptions:						
Receipts	–11.9	–18.5	–25.4	–27.1	–31.3	–35.7
Outlays:						
Inflation	–1.5	–2.2	–3.3	–4.2	–5.4	–6.6
Unemployment	–3.3	–1.8	–1.4	–1.9	–2.0	–2.0
Interest rates	5.1	12.3	14.2	13.4	11.2	8.6
Interest on changes in borrowing	0.3	1.2	2.7	4.2	5.8	7.6
Total, outlay increases (net)	0.7	9.5	12.3	11.5	9.7	7.6
Increase in deficit (–)	–12.6	–28.1	–37.7	–38.6	–41.0	–43.3
Budget totals under 1998 budget economic assumptions and policies:						
Receipts	1,505.4	1,566.8	1,643.3	1,727.3	1,808.3	1,896.7
Outlays	1,631.0	1,687.5	1,760.7	1,814.4	1,844.5	1,879.7
Surplus or deficit (–)	–125.6	–120.6	–117.4	–87.1	–36.1	17.0

point illustrated by this table, is the fact that of the $183 billion reduction in the actual budget deficit between 1992 and 1996 (from $290 billion to $107 billion), 41 percent ($75 billion) resulted from cyclical improvement in the economy. The rest of the reduction stemmed primarily from policy actions—mainly those in the Omnibus Budget Reconciliation Act of 1993, early in President Clinton's first term, which reversed a projected continued steep rise in the deficit.

Sensitivity of the Budget to Economic Assumptions

Both receipts and outlays are affected by changes in economic conditions. This sensitivity seriously complicates budget planning, because errors in economic assumptions lead to errors in the budget projections. It is therefore useful to examine the implications of alternative economic assumptions.

Many of the budgetary effects of changes in economic assumptions are fairly predictable, and a set of rules of thumb embodying these relationships can aid in estimating how changes in the economic assumptions would alter outlays, receipts, and the deficit.

Economic variables that affect the budget do not usually change independently of one another. Output and employment tend to move together in the short run: a higher rate of real GDP growth is generally associated with a declining rate of unemployment, while weak or negative growth is usually accompanied by rising unemployment. In the long run, however, changes in the average rate of growth of real GDP are mainly due to changes in the rates of growth of productivity and labor supply, and are not necessarily associated with changes in the average rate of unemployment. Inflation and interest rates are also closely interrelated: a higher expected rate of inflation increases interest rates, while lower expected inflation reduces rates.

Changes in real GDP growth or inflation have a much greater cumulative effect on the budget over time if they are sustained for several years than if they last for only one year.

Highlights of the budget effects of the above rules of thumb are shown in Table 1–7.

If real GDP growth is lower by one percentage point in calendar year 1997 only and the unemployment rate rises by one-half percentage point, the fiscal 1997 deficit would increase by $8.6 billion; receipts in 1997 would be lower by about $7.1 billion, and outlays would be higher by about $1.5 billion, primarily for unemployment-sensitive programs. In 1998, the receipts shortfall would grow further to about $15.2 billion, and outlays would be increased by about $5.2 billion relative to the base, even though the growth rate in calendar 1998 follows the path originally assumed. This is because the level of real (and nominal) GDP and taxable incomes would be permanently lower and unemployment higher. The budget effects (including growing interest costs associated with the higher deficits) would continue to grow slightly in later years.

The budget effects are much larger if the real growth rate is assumed to be one percentage point less in each year (1997–2002) and the unemployment rate to rise one-half percentage point in each year. With these assumptions, the levels of real and nominal GDP would be below the base case by a growing percentage. The deficit would be $143.0 billion higher than under the base case by 2002.

The effects of slower productivity growth are shown in a third example, where real growth is one percentage point lower per year while the unemployment rate is unchanged. In this case, the estimated budget effects mount steadily over the years, but more slowly, reaching a $120.8 billion deficit add-on by 2002.

Joint changes in interest rates and inflation have a smaller effect on the deficit than equal percentage point changes in real GDP growth because their effects on receipts and outlays are substantially offsetting. An example is the effect of a one percentage point higher rate of inflation and one percentage point higher interest rates during calendar year 1997 only. In subsequent years, the price level and nominal GDP would be one percent higher than in the base case, but interest rates are assumed to return to their base levels. Outlays for 1997 rise by $6.3 billion and receipts by $8.1 billion, for a decrease of $1.8 billion in the 1997 deficit. In 1998, outlays would be above the base by $15.6 billion, due in part to lagged cost-of-living adjustments; receipts would rise $16.5 billion above the base, however, resulting in a $0.9 billion decrease in the deficit. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays.

If the rate of inflation and the level of interest rates are higher by one percentage point in all years, the price level and nominal GDP would rise by a cumulatively growing percentage above their base levels. In this case, the effects on receipts and outlays mount

Table 1–6. ADJUSTED STRUCTURAL DEFICIT

(In billions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Unadjusted surplus (–)/deficit	290.4	255.0	203.1	163.9	107.3	125.6	120.6	117.4	87.1	36.1	–17.0
Cyclical component	68.7	52.6	24.2	2.3	–6.7	–10.3	–3.7	0.0	0.0	0.0	0.0
Structural deficit	221.7	202.6	178.9	161.6	114.0	135.9	124.4	117.4	87.1	36.1	–17.0
Deposit insurance outlays	–2.4	–28.0	–7.6	–17.8	–8.4	–12.1	–4.0	–2.0	–1.1	–1.6	–1.5
Adjusted structural surplus(–)/deficit	224.1	230.4	186.5	179.5	122.4	148.0	128.4	119.4	88.3	37.7	–15.5

steadily in successive years, adding $75.1 billion to outlays and $101.1 billion to receipts in 2002, for a net reduction in the deficit of $26.0 billion.

The table also shows the interest rate and the inflation effects separately, and rules of thumb for the added interest cost associated with higher or lower deficits (increased or reduced borrowing). The effects of changes in economic assumptions in the opposite direction are approximately symmetric to those shown in the table. The impact of a one percentage point lower rate of inflation or higher real growth would have about the same magnitude as the effects shown in the table, but with the opposite sign.

These rules of thumb are computed while holding the income share composition of GDP constant. Because different income components are subject to different taxes and tax rates, estimates of total receipts can be affected significantly by changing income shares. These relationships, however, have proved too complex to be reduced to simple rules.

Table 1–7. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

(In billions of dollars)

Budget effect	1997	1998	1999	2000	2001	2002
Real Growth and Employment						
Budgetary effects of 1 percent lower real GDP growth:						
For calendar year 1997 only: [1]						
Receipts	–7.1	–15.2	–17.4	–17.7	–18.2	–18.8
Outlays	1.5	5.2	6.5	7.7	8.9	10.2
Deficit increase (+)	8.6	20.4	23.9	25.4	27.1	29.0
Sustained during 1997–2002: [1]						
Receipts	–7.1	–22.4	–40.6	–59.8	–80.2	–101.9
Outlays	1.5	6.8	13.3	21.2	30.2	41.1
Deficit increase (+)	8.6	29.2	53.9	81.0	110.4	143.0
Sustained during 1997–2002, with no change in unemployment:						
Receipts	–7.1	–22.7	–41.6	–62.2	–84.2	–108.1
Outlays	0.2	1.0	2.6	5.0	8.3	12.7
Deficit increase (+)	7.3	23.7	44.2	67.1	92.5	120.8
Inflation and Interest Rates						
Budgetary effects of 1 percentage point higher rate of:						
Inflation and interest rates during calendar year 1997 only:						
Receipts	8.1	16.5	16.4	15.3	16.1	16.9
Outlays	6.3	15.6	12.9	11.8	11.3	11.1
Deficit increase (+)	–1.8	–0.9	–3.4	–3.5	–4.8	–5.8
Inflation and interest rates, sustained during 1997–2002:						
Receipts	8.1	25.0	42.6	60.3	79.7	101.1
Outlays	6.3	22.3	36.7	50.1	62.7	75.1
Deficit increase (+)	–1.8	–2.6	–5.9	–10.2	–17.0	–26.0
Interest rates only, sustained during 1997–2002:						
Receipts	1.1	2.8	3.6	3.9	4.2	4.5
Outlays	5.8	17.6	25.4	31.1	35.7	39.3
Deficit increase (+)	4.7	14.8	21.8	27.2	31.5	34.8
Inflation only, sustained during 1997–2002:						
Receipts	7.0	22.1	39.0	56.4	75.5	96.6
Outlays	0.4	4.7	11.3	19.0	27.0	35.8
Deficit increase (+)	–6.6	–17.4	–27.7	–37.4	–48.5	–60.9
Interest Cost of Higher Federal Borrowing						
Effect of $100 billion additional borrowing during 1997	2.9	5.4	5.3	5.3	5.3	5.4

[1] The unemployment rate is assumed to be 0.5 percentage point higher per 1.0 percent shortfall in the level of real GDP.